TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 01-30

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted from is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Application of Tennessee sales and use tax to the sales of tangible personal property previously used by the taxpayer in fulfilling its management contract with the federal government.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

(A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
(B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
(C) The applicable law must not have been changed or amended;
(D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
(E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[THE TAXPAYER] assumed the responsibility of management contractor at the United States [GOVERNMENT AGENCY] [FACILITY] in [CITY], Tennessee on [DATE]. Pursuant to Contract [NUMBER][1] (hereinafter Contract), the Taxpayer operates the [FACILITY]. The Taxpayer explains that it fabricates and processes [SPECIFIC] components at the [FACILITY] for [GOVERNMENT AGENCY]. Also, the taxpayer processes [PRODUCTS] for re-use, produces mock or inert components for use in [GOVERNMENT AGENCY]'s testing of [TYPE OF SYSTEMS], produces test hardware for [SPECIFIC TYPE] laboratories, and manufactures special hardware for other government and certain private entities outside the [GOVERNMENT AGENCY]. The Taxpayer describes its primary responsibility under the contract and its primary activity at the [FACILITY] as the manufacture and/or processing or fabricating of [SPECIFIC TYPE] components and other goods for resale and use or consumption off the premises as defined under the applicable Tennessee Sales and Use Tax statutes.

In connection with its manufacturing operation at [FACILITY], the Taxpayer will sell certain items of tangible personal property. These items are procured by the Taxpayer and used in the performance of the Contract at [FACILITY], but are no longer needed in performing the Contract at the time of sale. None of these items will be procured by the Taxpayer for resale. Title to these items of tangible personal property is in the federal government not the Taxpayer. The Taxpayer will be registered as a dealer for use tax purposes and will remit to the Department of Revenue any applicable use taxes arising under T.C.A. Section 67-6-209 from its use of this tangible personal property in the performance of its Contract. However, any property that may qualify as exempt "industrial machinery" will not have been previously taxed. Illustrative examples of the types of items, the amount received and the proceeds from the sales made by the Taxpayer's predecessor during the 2000 fiscal year have been provided. The items that will be sold include timber; scrap metal, used office paper and other recyclables; miscellaneous equipment and vehicles; furniture; and other miscellaneous items. Within the course of each year, approximately forty to fifty such sales are expected. These sales produced in excess of $[AMOUNT] annually for the predecessor. By far, timber was the item generating the most revenue from these sales. More than $[AMOUNT] was received through four separate sales of timber by the predecessor company. The predecessor's sales of timber were made entirely through sealed bids. The Taxpayer will also make sales of some surplus property by direct negotiation, sealed bids, or auction.

The Taxpayer explains that its sales of surplus property are made as the agent of the federal government. The Taxpayer states this agency relationship is set out in Contract with the [GOVERNMENT AGENCY]. The Contracting Officer for the [GOVERNMENT AGENCY] has provided written confirmation that the Taxpayer

[1] A copy of this voluminous contract was not provided by the Taxpayer.

makes the sales of surplus property as agent of the [GOVERNMENT AGENCY][2]. The Contracting Officer for [GOVERNMENT AGENCY] further explains that pursuant to the Contract the funds from these sales are used to reduce the costs allowable to the Taxpayer pursuant to the Contract. The Taxpayer states this principal/agent relationship is also disclosed to purchasers by written documentation or otherwise. The Taxpayer has provided copies of four documents related to a sale it has already made to one individual of several different surplus items[3]. This sample re-enforces the Taxpayer's representation that its sales of surplus [GOVERNMENT AGENCY] property are made as the agent of [GOVERNMENT AGENCY] and that purchasers are aware of this agency.

The Taxpayer contends all of the proposed sales of [GOVERNMENT AGENCY] property (excluding sales of motor vehicles) should be exempt as casual and isolated sales pursuant to T.C.A. Section 67-6-102(2), Tenn. Comp. R. Regs. 1320-5-1.09 and other applicable authorities. In the alternative, the Taxpayer contends these sales are not subject to tax since it acts as the agent of the [GOVERNMENT AGENCY] in making the sales.

QUESTION

1. Are sales by the Taxpayer of surplus tangible personal property used in the performance of its Contract excluded from application of the Tennessee Sales Tax as "occasional and isolated sales"?

2. Are the sales by the Taxpayer of surplus tangible personal property used in the performance of its Contract excluded from application of the Tennessee Sales Tax because it makes these sales as the agent of the [FEDERAL AGENCY]?

RULINGS

1. No. The extent and expected regularity of these sales indicate they are not excepted from the sales tax as "occasional and isolated sales".

2. The Taxpayer is not subject to the requirement to collect or remit the sales or use tax on sales it makes as the disclosed agent for the [GOVERNMENT

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[2] A copy of a letter from [GOVERNMENT AGENCY]'s Contracting Officer to the Taxpayer's Attorney dated [DATE].

[3] (1) An invoice ,dated [DATE], signed by the purchaser, [NAME], for several items. The invoice says the Taxpayer is "the Sales Agent acting for the [GOVERNMENT AGENCY]"; (2) A "Certificate to Obtain Title to a Vehicle", dated [DATE], that shows the transfer of title to a vehicle from [GOVERNMENT AGENCY] to [NAME]. (3) A Bill of Sale, dated [DATE], from the Taxpayer to [NAME] for the [SPECIFIC ITEM] shown on the [NAME] invoice; and (4) A copy of a credit card transaction, dated [DATE], signed by [NAME] in payment to the Taxpayer and [GOVERNMENT AGENCY] for all the items purchased on the [DATE] invoice, including sales tax.

AGENCY]. However, purchasers who obtain title and/or possession of the surplus property in Tennessee or who use the untaxed property in Tennessee are secondarily liable for the sales or use tax.

ANALYSIS

1. Occasional [Casual] and Isolated Sales[4].

The Case Law

There is limited Tennessee case law on the subject of "occasional and isolated sales". The Taxpayer has cited and relied upon *Liberty Cash Grocers Inc. v. Adkins*, 304 S. W. 2d 633 (Tenn. 1957). In that case, the Tennessee Supreme Court considered application of the sales tax to the sale of assets by a corporation that operated a wholesale and retail grocery chain. The taxpayer sold its store, warehouse, office fixtures, motor vehicles and other equipment used in its business to another business. The taxpayer contended the sale was casual and isolated. It is important to note that the rules of the Department in effect at the time of this decision did not allow the sale as a casual and isolated sale. However, the Court applied the statute to conclude the sale was casual and isolated notwithstanding the rule[5]. The Court said:

> While the complainant was engaged in the business of selling tangible property, it was not engaged in the business of selling tangibles such as its fixtures and equipment. In support of this conclusion, it must be presumed that when the merchandise and equipment in question was acquired for complainant's own use, the law was complied with, and said personal property had, therefore, already been burdened with a sales tax.

There is a distinct and critical factual difference between the one time liquidation of a business involved in the *Liberty Cash Grocers* case and the ongoing sale of surplus property involved in this ruling. This case is not controlling.

A more recent Tennessee case on this subject is *SC & T Properties v. Huddleston*, 823 S.W.2d 541, (Tenn. 1992). In this case, the taxpayer's only business activity prior to a sequence of events that led to the tax assessment was the nontaxable leasing of real property to a teleproduction company. The taxpayer's only customer learned that another company engaged in teleproductions was attempting to sell all its equipment. Since the taxpayer's customer needed a routing and switching system, the taxpayer negotiated the purchase of the entire teleproductions unit in order to acquire the routing and switching system for its customer. The taxpayer negotiated and obtained all the

[4] Tenn. Admin Comp. 1320-5-1-.09 uses the word "casual" instead of the word "occasional" used in T.C.A. Section 67-6-102(2).
[5] The rule was subsequently amended as a result of this decision.

equipment for $250,000 but the seller insisted the taxpayer provide a resale certificate. This required the taxpayer to register for sales and use taxes purposes. Upon obtaining the equipment, the taxpayer leased the routing and switching equipment to its customer. Sales taxes were collected and remitted on this lease. However, approximately ten days after the purchase, the taxpayer was approached by another party interested in purchasing the balance of the teleproduction equipment. The taxpayer successfully negotiated this additional sale in the amount of $600,000. The Department of Revenue assessed sales tax on this sale. The Supreme Court upheld the assessment though the taxpayer contended the sale was casual and isolated. The use of the resale certificate to purchase the tangible personal property was paramount in the collective mind of the Court. The Court applied the portion of the present rule, Tenn. Admin. Comp. 1320-5-1-.09, that indicates even "few and infrequent sales" of tangible property purchased using a resale certificate are to be taxed. The facts of this Tennessee case are also distinctly different from the facts presented by this ruling. This case is also not controlling since a resale certificate will not be used to purchase the property that is later sold as surplus.

In *Reynolds Elec. & Engineering Co., Inc. v. State,* 930 P.2d 746, (Nevada 1997) facts very similar to those presented by the Taxpayer were considered. The taxpayer in this case was a contractor engaged in a management and operating contract with the United States Department of Energy (DOE). It also managed auctions of surplus federal government property. The Nevada Department of Taxation ordered the taxpayer to pay state sales tax on sales of United States property. The Court concluded the taxpayer was not a "retailer" under Nevada law, and therefore was exempt from sales tax liability. However, this case involved the application of sales tax statutes too different from the Tennessee law for it to be helpful.

There is no case law on point with both the statute and the facts presented by this ruling request. Whether there is an exclusion of these sales of surplus property from the sales tax as casual or isolated sales must be treated as a case of first impression.

The Statute and the Rule

T.C.A. Section 67-6-201(1) establishes the relevant taxable privilege. Every person engaging in the business of selling tangible personal property at retail in this state exercises the taxable privilege. "Person" is defined very broadly by T.C.A. Section 67-6-102(21).

> "Person" includes any individual, firm, co-partnership, joint venture, association, corporation, estate, trust, business trust, receiver, syndicate, any governmental agency whose services are essentially a private commercial concern, or other group or combination acting as a unit, in the plural as well as the singular number. "Person" further

> includes any political subdivision or governmental agency, including electric membership corporations or cooperatives, and utility districts, to the extent that such agency sells at retail, rents or furnishes any of the things or services taxable under this chapter;

It can be seen that the Taxpayer is a person under this definition. Furthermore, governmental entities including the federal government are also persons under this definition. A person must also be engaged in the business of selling tangible personal property for the tax to apply. The definition of “business” is provided by T.C.A. Section 67-6-102(2). It is the exclusions from application of the sales tax for “casual and isolated sales” found in this definition that must be interpreted.

> "Business" includes any activity engaged in by any person, or caused to be engaged in by such person, with the object of gain, benefit, or advantage, either direct or indirect. *"Business" does not include occasional and isolated sales or transactions by a person not regularly engaged in business*, or the occasional and isolated sale at retail or use of services sold by or purchased from a person not regularly engaged in business as a vendor of taxable services, or from one who is such a vendor but is not normally a vendor with respect to the services sold or purchased in such occasional or isolated transaction. "Business" includes occasional and isolated sales or transactions of aircraft, vessels, or motor vehicles between corporations and their members or stockholders and also includes such transactions caused by the merger, consolidation, or reorganization of corporations. "Business" also includes occasional and isolated sales or transactions of aircraft, vessels, or motor vehicles between partnerships and the partners thereof and transfers between separate partnerships. Transfers caused by the dissolution of a partnership due solely to a partner, in a partnership composed of three (3) or more persons, voluntarily ceasing to be associated in the carrying on of business of the partnership, as provided in Section 61-1-128, is not included in "business." "Business" shall be construed to include occasional and isolated sales or transactions by such a person involving aircraft, vessels or motor vehicles (which terms include trailers and special motor equipment sold in conjunction therewith), as defined by and required to be registered under the laws of Tennessee with an agency of this state or under the laws of the United States with an agency of the federal government, unless such sales or transactions are otherwise exempt under this chapter or are sales between persons who are: married, lineal relatives or spouses of lineal relatives, or siblings. Such sales or transactions involving aircraft based in this state shall be presumed to be made and taxable in this state; and any registration reflecting such aircraft which are so based shall constitute evidence thereof. "Business" does not include those occasional or isolated sales or transactions by such a person involving mobile homes

> or house trailers, as defined by Section 55-4-111, when the consummation of such exclusively involves the assumption by the purchaser of a previously existing finance contract and no other consideration is received by the seller. *"Business" does not include any sales or use tax of tangible personal property of any type sold directly to consumers by any person, including, but not limited to, the Girl Scouts or county fairs; provided, that the tangible personal property is not regularly sold by such person or is regularly sold by such person only during a temporary sales period which occurs on a semiannual, or less frequent, basis;*

(Emphasis Mine). The Department's administrative rule, Tenn. Admin. Comp. 1320-5-1-.09, aids in the interpretation of the statute. It provides in relevant part:

> 1. The Sales Tax does not apply to casual and isolated sales by persons who are not, or who have been deemed by the Commissioner not to be engaged in the business of selling tangible personal property or furnishing any of the services subject to the Sales or Use Tax. *The Sales Tax, likewise, does not apply to sales of tangible personal property or taxable services not normally sold by a dealer and which has been used by the dealer prior to the sale;* this exemption however, does not apply to any sales of tangible personal property or taxable services bought upon a resale certificate for resale by those persons who hold themselves out as engaged in business, notwithstanding the fact that the sales may be few and infrequent. The exemption also does not apply to the casual and isolated sale of aircraft, vessels and motor vehicles which are required to be registered by the State of Tennessee or the U.S. Government.
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> *4.Irregular sales of tangible personal property or regular sales of tangible personal property made only during a temporary sales period occurring on a semiannual or less frequent basis are casual and isolated sales not subject to tax. If a person other than a public or private school, grades K-12, or school group has or conducts more than two (2) sales periods during a calendar year, such person shall be liable for sales tax on all sales during that calendar year.* Public and private schools, grades K-12, and school support groups having or conducting more than two (2) sales periods during a calendar year, having purchased tangible personal property or taxable services without the payment of tax, shall be liable for the use tax based on the purchase price of the items or services purchased during that calendar year. A sales period shall be presumed to be temporary if it is of 30 consecutive days duration or less. Persons making purchases of tangible personal property or taxable services for resale during temporary semiannual or annual sales periods shall provide their

> vendor with a written statement indicating that the items or services will be sold during a semiannual or annual sales period.

(Emphasis mine). Tenn. Admin. Comp. 1320-5-1-.09.

The Taxpayer is a dealer but a resale certificate will not be used to purchase the tangible personal property exempt from tax[6] that is used by the Taxpayer and later sold as surplus. Accordingly, under Paragraph (1) of the Rule it is only necessary to demonstrate that the surplus property is not normally sold by the Taxpayer for the exception to apply. However, Paragraph (1) must be applied consistently with Paragraph (4).

Paragraph (4) provides an even broader exclusion from the tax for casual and isolated sales that includes some regular sales periods. If sales are made during a temporary sales period on a regular semi-annual or annual basis they still are excluded as casual and isolated sales by Paragraph (4) of the Rule. However, Paragraph (4) clearly states that if there are more than two (2) sales periods during the calendar year the casual and isolated exclusion from tax does not apply.

Under Paragraph (4) of the Rule, the sales of the Taxpayer do not qualify as casual and isolated sales. The Taxpayer will have more than two sales periods. The Taxpayer plans as many as forty to fifty different and separate sales periods during the year. Since the sales of the taxpayer do not qualify as "casual and isolated sales" under the broader exclusion of Paragraph (4), they would also not qualify as casual and isolated sales under Paragraph (1). Indeed, the same types of surplus items are sold by the Taxpayer on a continuing and regular basis. It does not follow that these surplus items "are not normally sold" so as to be excluded from sales tax as casual and isolated sales under Paragraph (1) of the rule.

2.The Agency Issue

Sales by factors, auctioneers, or agents are also addressed in the Department's rules:

> Every factor, auctioneer, or agent acting for any unknown or undisclosed principal entrusted with any bill of lading, customhouse permit, or warehouse receipt for delivery of tangible personal property, or entrusted with possession of any such personal property for the purpose of sale, shall be deemed the owner thereof, and, upon the

[6] It is possible some other exemption may apply so that tax may not be paid upon the purchase of the property in every instance. However, this Letter Ruling does not address possible application of other exemptions to the purchase or use of tangible personal property by the Taxpayer. Whether or not the Taxpayer qualifies as a manufacturer for purposes of sales or use tax exemptions afforded manufacturers, and whether or not any machinery or equipment used by the Taxpayer qualifies as exempt industrial machinery is beyond the scope of this Letter Ruling.

> sale at retail of such property, shall be required to file a return of the receipts of sales and pay a tax thereon. A sale by such factor, auctioneer or agent, when acting for a known or disclosed principal shall be taxable to the principal. The same rule applies to lien holders, such as storage men, pawnbrokers and artisans.

Tenn. Admin. Comp. 1320-5-1-.01. Based upon the facts presented, the Taxpayer is acting as an agent for the [GOVERNMENT AGENCY]. The Taxpayer neither owns the surplus property it sells nor sells the property in its own name, i.e. the federal government is the disclosed principal. Since the principal is disclosed, the tax responsibility, if any, is that of the principal.

Application of the sales tax to a sale by the federal government is discussed in the Tennessee case of *Texas Eastern Transmission Corporation v. Benson*, 480 S.W.2d 905 (Tenn. 1972). In *Texas Eastern,* the Court considered a sale of electricity made in Tennessee by the Tennessee Valley Authority. The incidence of the sales tax in Tennessee is upon the vendor, but the tax in this case was assessed against TVA's purchaser. The Court determined TVA sold and delivered the electricity to the complainant in Tennessee resulting in a local taxable sale. However, the tax could not be levied against TVA because of its immunity from state taxation. The Court said:

> The second question raised by complainant is that the sales tax is levied on the seller, in this case TVA, which seller, as an agency of the United States Government, enjoys immunity from state taxation. We agree if this is a tax on TVA, such is invalid. *United States of America v. County of Allegheny, Pa*., 322 U.S. 174, 64 S.Ct. 908, 88 L.Ed. 1209 (1944). The State in its answer admits under the sales tax by T.C.A. § 67-3003, the primary liability is upon the seller, but in this case the seller being immune and refusing to collect the tax, then the State has proceeded to collect from one secondarily liable; in this case the complainant. Title 67, Chapter 30, of Tennessee Code Annotated, embodies in its provisions an obvious and clear scheme of taxation. This system of taxation contemplates a sales tax to be levied on the vendor, T.C.A. § 67-3003, and a complementary use tax to be levied upon the entirely distinct privilege of importing tangible property into Tennessee for its use here, T.C.A. § 67-3005. The overall scheme envisions a system of taxation where the tax is due because of a sales transaction within the state, or, where the tax is due because of the importation of property in the state for use here. Nevertheless, there is a theme of equality which runs through the main stream of all these statutory provisions. Both the sales tax, T.C.A. § 67-3003, and the use tax, T.C.A. § 67-3005, provide that the tax cannot be levied where it would result in a duplication of tax. T.C.A. § 67-3008, in like manner allows credit for taxes paid in other states. This system of taxation presupposes that all tangible personal property is subject to a sales

> tax, be it either in Tennessee or in another state. The purpose of such a system is readily perceived. No one who purchases property in Tennessee is to be exempt from the sales tax except to the extent that he has paid a use or sales tax somewhere.
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> This simply means that the taxable incident aimed at by this 'use' aspect of the law is the sales transaction. Where there has been a sale, a tax is due and payable, first from the vendor, if it can be collected from him, and then, if not, from the vendee or the user of the property. In the latter case, the tax is collected, not as a use tax, but as a sales tax.

Id. p. 909, 910. Clearly the federal government may not be required to collect the sales or use tax on its sales in Tennessee. However, the Court has also clearly shown the constitutional bar to collection from the federal government does not apply to collections from those secondarily liable. In this case that means the purchasers of the surplus property from the Department of Energy may be held liable for the tax.

In 1978, the Tennessee Attorney General was requested to consider the application of the sales or use tax to sales of services by the DOE actually performed by its contractor. The question addressed involved the possible sales or use tax liability of the DOE, its contractors and customers for the enrichment of uranium. The enrichment of uranium is one of the services subject to the sales and use tax. T.C.A. Section 67-6-102(24)(F)(vii).

The Attorney General recognized the incidence of the Tennessee sales tax was upon the vendor and first commented on the possible liability of DOE, and then Union Carbide, the contractor engaged in the operation of the Y-12 Plant, for the sales tax due on the service.

> It is well settled that the federal constitution forbids the imposition of a state tax whose legal incidence falls upon the federal government, its property or its instruments. *M'Cullouch v. Maryland*, 17 U.S. 316, 4 L.Ed. 579 (1819); *United States v. Boyd*, 378 U.S. 39, 12 L.Ed.2d 713, 84 S.Ct. 1518 (1964).
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> Carbide, however, is not a party to the uranium enrichment contracts with the utility companies, such contracts being between the United States government as represented by the Department of Energy, and the customers. Therefore, although Carbide may operate the plant which performs the enriching operations, it performs no contractual service for the customers and receives no direct fee from the

> customers. According[ly] the legal incidence of the sales tax with respect to the service of enriching uranium would not be upon Carbide.

Tenn. Op. Atty. Gen. No. 78-2731, 1978 WL 27213(Tenn. A.G.)

The Attorney General found the Supremacy Clause provided federal immunity for the vendor, DOE. Since the contractor was not a party to the taxable service, it had no responsibility for the tax. However, following the rationale of the *Texas Eastern* case, the Attorney General concluded the vendees of the enrichment services (the customer-utilities) would be secondarily liable for the sales tax because the federal government is immune from Tennessee sales and use taxation. The Attorney General said:

> It is the opinion of this office that pursuant to T.C.A. § 67-3002 as amended by Chapter 565, Public Acts 1978, [now codified at T.C.A. Section 67-6-102(24)(F)(vii)] the Department of Revenue can proceed to collect a sales tax with respect to the fees charged for the enrichment of uranium in Tennessee from the customer-utilities who contract with the United States Department of Energy for the enrichment of uranium.

Tenn. Op. Atty. Gen. No. 78-2731, 1978 WL 27213(Tenn. A.G.) This opinion rested squarely upon the Court's decision in opinion in *Texas Eastern Transmission Corporation v. Benson,* in concluding that customers of DOE are subject to the sales tax.

Charles Moore
Special Tax Counsel

APROVED: Ruth E. Johnson
Commissioner of Revenue

DATE: December 13, 2001